

**Multistate Tax Commission**  
**Income & Franchise Tax Uniformity Subcommittee**

**Working Draft**  
**Model Uniform Statute for**  
**Combined Reporting**

*July 15, 2004*  
*Draft – for Discussion Purposes Only*

**Section 1. Definitions.**

- A.** “Person” includes any, partnership, limited liability company, limited liability partnership, association taxed as a corporation, or corporation
- B.** “Taxpayer” means any person subject to the tax imposed by [income tax act].
- C.** “Internal Revenue Code” means Title 26 of the United States Code of [date] [and amendments thereto] without regard to application of federal treaties unless expressly made applicable to states of the united states.
- D.** “Unitary business” means a single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.
- E.** “Combined group” means the group of all persons whose income and apportionment factors are required to be taken into account in determining the taxpayer’s share of the net business income or loss which is apportionable to this State.
- F.** “United States” means the 50 states of the United States, the District of Columbia, and US territories and possessions.
- G.** “Tax haven” means a jurisdiction which:
- i.** has been identified by the Organization for Economic Co-operation and Development (OECD) as a tax haven, or
  - ii. (a)** has no or nominal tax on the relevant income (from geographically mobile financial and other service activities);
    - (b)** has no effective exchange of information with respect to the regime;
    - (c)** has regimes which lack transparency, e.g. the details of the regime or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure; and

(d) facilitates the establishment of foreign owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy; or

iii. the director determines has created a regime which is favorable for tax avoidance, based upon all the facts and circumstances, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

## **Section 2. Combined reporting required, when; discretionary under certain circumstances.**

**A. Combined reporting required, when.** A taxpayer engaged in a unitary business with one or more other persons shall file a combined report which includes the income, determined under 3.C.i. and 3.C.ii. of this act, and apportionment factors, determined under [provisions on apportionment factors], of all persons which are members of the unitary business and such other information as required by the Director .

**B. Combined reporting at Director's discretion, when.** Where the Director determines that the reported income or loss of a person or group of persons, as that term is defined in Section 1.A., which is engaged in a unitary business with an individual, entity or organization of any kind which is not included within the meaning of Section 1.A., does not clearly reflect income or loss of such person or group of persons or represents an evasion of tax by such person or one or more members of such group of persons, and the Director determines that the comparable uncontrolled price method prescribed by regulations pursuant to Section 482 of the Internal Revenue Code cannot practically be applied, the Director may, in lieu of other methods prescribed by regulations pursuant to Section 482 of the Internal Revenue Code, apply methods of combined reporting to properly reflect the income or loss of such unitary person or group of persons.

## **Section 3. Determination of taxable income or loss using combined report.**

### **A. Components of taxable income.**

The use of a combined report does not disregard the separate identities of the taxpayer members of the combined group. Each taxpayer member is responsible for tax based on its taxable income or loss, which shall include:

- i. its share of any business income apportionable to this State of each of the combined groups of which it is a member, determined under Section 3.B.,
- ii. its share of any business income apportionable to this State of a distinct business income activity conducted within and without the state wholly by the taxpayer member, determined under [provisions for apportionment of business income],
- iii. its business income from a trade or business conducted wholly by the taxpayer member entirely within the state,

- iv. its income sourced to this state from the sale or exchange of capital or assets, and from involuntary conversions, as determined under [provisions for],
- v. its nonbusiness income or loss allocable to this State, determined under [provisions for allocation of non-business income],
- vi. its income or loss allocated or apportioned in an earlier year, required to be taken into account as state source income during the income year, other than a net operating loss,
- vii. its net operating loss carryover or carryback.

Unless otherwise provided, any tax credit earned by one member of the group, but not used by that member, may not be used by another member of the group.

**B. Determination of taxpayer's share of the business income of the combined group apportionable to this State.**

The taxpayer's share of the business income apportionable to this State of each combined group of which it is a member shall be determined as follows:

- i. from the total income of the combined group, determined under [Section 3. C.], subtract any nonbusiness income, and add any nonbusiness loss, included in the total; then
- ii. multiply the amounts determined under [Section 3.B.i.] by the taxpayer's apportionment percentage, determined under [provisions on apportionment factors], including in the numerator the taxpayer's [property, payroll and sales] of the combined group's unitary business in this state, and including in the denominator the [property, payroll and sales] of the unitary business of all persons that are members of the combined group, including the taxpayer.

**C. Determination of the total income of the combined group.**

The total income of the combined group is the sum of the incomes, separately determined, of each person who is a member of the combined group. The income of each person who is a member of the combined group shall be determined as follows:

- i. For any person incorporated in the United States, or included in a consolidated federal corporate income tax return, the income to be included in the combined report shall be the taxable income for the corporation after making appropriate adjustments under [state tax code provisions for adjustments to taxable income].
- ii. (a) For any person not included in [Section 3.C.i.], the income to be included in the combined report shall be determined as follows:
  - (1) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.
  - (2) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.
  - (3) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required by the [state tax code]

(4) The profit and loss statement of each branch or corporation, whether United States or foreign, shall be translated into the currency in which the parent company maintains its books and records.

(5) Business and nonbusiness income as determined in accordance with [provisions defining business income] and [provisions defining non-business income] shall be identified and segregated.

(6) Nonbusiness income shall be allocated to a specific state pursuant to [provisions on allocation of nonbusiness income].

(7) Business income shall be included in the combined report prepared for the unitary business and shall be apportioned on the basis of the appropriate formula for the business.

(8) Income from [state] sources shall be expressed in dollars.

(b) In lieu of the procedures set forth above and subject to the determination of the Director that it reasonably approximates income as determined under [the state tax code], a unitary business with operations in a foreign country may determine its income on the basis of the consolidated profit and loss statement prepared for the related corporations of which the unitary business is a member which is prepared for filing with the Securities and Exchange Commission. If the business is not required to file with the Securities and Exchange Commission, the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor may be used.

iii. All dividends paid by one to another of the members of the combined group shall, to the extent those dividends are paid out of the earnings and profits of the unitary business included in the combined report, be eliminated from the income of the recipient. This provision shall not apply to dividends received from members of the unitary business which are not a part of the combined group pursuant to a water's-edge election under [§4 of this act].

iv. If the income computation under [Section 3.A.] results in a loss for a taxpayer member, that taxpayer member has a [state] net operating loss (NOL), subject to the net operation loss limitations and carryforward provisions of [provisions on NOLs]. Such NOL is applied as a deduction in a subsequent year only when the taxpayer has [State] source positive net income, whether or not the taxpayer is a member of a combined reporting group in the subsequent year. An NOL incurred by one member of a combined reporting group cannot be used to reduce the income of any other member in a subsequent income year. Whether the NOL resulted from an apportioned business loss or an allocated nonbusiness loss, or a combination of both, the NOL is a deduction against positive [State] source income in a subsequent year, regardless of the composition of that income as apportioned, allocated or wholly within [State].

#### **D. Designation of surety.**

As a filing convenience, and without changing the respective liability of the group members, members of a combined reporting group may elect to designate one taxpayer to file a single return in the form and manner prescribed by the department, in lieu of filing their own respective returns, provided that the taxpayer designated to file the single return consents to act as surety with respect to the tax liability of all other taxpayers properly

included in the combined report. If for any reason the surety is unwilling or unable to perform its responsibilities, tax liability may be assessed against the taxpayer members.

**Section 4. Water's-edge election; initiation and withdrawal; treatment of income received from unitary members not included in the combined report.**

**A. Water's-edge election.**

Notwithstanding [Section 2], taxpayer members of a unitary group that meet the requirements of [Section 4.B.] may elect to determine each of their apportioned shares of the net business income or loss of the combined group pursuant to a water's-edge election. Under such election, taxpayer members shall take into account the income and apportionment factors of only the following members of the unitary business:

- i. any corporation incorporated in the United States;
- ii. any corporation, regardless of the place where it is incorporated, if the average of its property, payroll, and sales factors within the United States is 20 percent or more;
- iii. any foreign sales corporation as described in §§921 to 927, inclusive, of the Internal Revenue Code; and any export trade corporation, as described in §§970 to 971, inclusive, of the Internal Revenue Code;
- iv. any corporation that is not described in [Section 4.A.i.] to [Section 4.A.iv.], inclusive, but only to the extent of its income derived from or attributable to sources within the United States, as determined under the Internal Revenue Code, and its factors assignable to a location within the United States; by the corporation with respect to its activities conducted within the United States;
- v. any corporation that is a "controlled foreign corporation," as defined in Section 957 of the Internal Revenue Code, to the extent the income of that affiliate is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income"), and excluding any item of income received by a controlled foreign corporation if the taxpayer establishes to the satisfaction of the Director that such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in §11 of the Internal Revenue Code; and
- vi. any corporation that is doing business in a tax haven.

**B. Initiation and withdrawal of election**

i. A water's-edge election is effective only if made on a timely-filed, original return for a tax year by every member of the unitary business subject to tax under [state income tax code]. The Director shall develop rules and regulations governing the impact, if any, on the scope or application of a water's-edge election, including termination or deemed election, resulting from a change in the composition of the unitary group, the combined group, the taxpayer members, and any other similar change.

ii. Such election shall constitute consent to the reasonable production of documents and taking of depositions.

iii. A water's-edge election may be disregarded, and the income of the taxpayer determined without regard to the provisions of this section if any member of the unitary group fails to comply with any provision of [this act].

**iv.** A water's-edge election is binding for and applicable to the tax year it is made and all tax years thereafter. It may be withdrawn or reinstituted after withdrawal, only upon written request for reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes, law, or policy, and only with the written permission of the Director. If the Director grants a withdrawal of election, he or she shall impose reasonable conditions as necessary to prevent the evasion of tax or to clearly reflect income for the election period prior to or after the withdrawal.